



**REPORT OF THE AUDITOR OF PUBLIC ACCOUNTS**  
**AUDIT EXAMINATION OF THE REVENUE CABINET**

**Made as Part of the Statewide Single Audit  
of the Commonwealth of Kentucky**

**For the Year Ended June 30, 2000**

**EDWARD B. HATCHETT, JR.**  
**AUDITOR OF PUBLIC ACCOUNTS**  
**WWW.KYAUDITOR.NET**

**144 CAPITOL ANNEX  
FRANKFORT, KY 40601  
TELE. (502) 564-5841  
FAX (502) 564-2912**



**EXECUTIVE SUMMARY**  
**REPORT OF THE AUDITOR OF PUBLIC ACCOUNTS**  
**AUDIT EXAMINATION OF THE REVENUE CABINET**  
**FOR THE YEAR ENDED JUNE 30, 2000**

**BACKGROUND:**

The Federal Single Audit Act of 1984, subsequent amendments, and corresponding regulations, requires the auditing of financial statements and the compliance and internal controls applicable to federal moneys received by the Commonwealth of Kentucky. To comply with these requirements we audited internal controls and compliance at both the central and agency level. This summary is on our audit of one organizational unit of the Commonwealth, the Revenue Cabinet.

**RECEIPTS:**

The Revenue Cabinet received \$6,216,086,340 for the fiscal year ended June 30, 2000, through various tax types. We audit the largest of these revenue programs annually as part of our Statewide Single Audit.

**SUMMARY OF AUDITOR'S RESULTS:**

**Financial Statement Accounts**

There were no new audit findings for FY 2000. However, problems noted in past audits continue to exist. The Revenue Cabinet reported that the new Kentucky Integrated Tax Entity System would correct several deficiencies noted in the past. However, as of June 30, 2000, this system was not fully operational.

Also, the proposed Modernized Front End was to be up and running. Modernized Front End should provide the Revenue Cabinet with the means to process returns more completely and do a better job with compliance efforts. The new Modernized Front End is expected to clear other deficiencies noted in the past. However, as of June 30, 2000, this project was not fully operational.

Other deficiencies were due to lack of staff. For example, Motor Fuel Reports are not being cross-checked as required. We noted in the prior audit that there was a \$27 million mistake or potential refund for Motor Fuels. If this internal control feature had been in place and kept up to date, the mistake would have been caught sooner. A Revenue Cabinet employee stated that they do not have the staff to do the cross-check, but are trying to remedy this.



## **CONTENTS**

### **Page**

### **INTRODUCTION**

Introduction .....	2
Schedule Of Findings And Questioned Costs .....	2
Audit Approach .....	3
List Of Abbreviations/Acronyms Used In This Report.....	3

### **REPORT ON COMPLIANCE AND INTERNAL CONTROL**

Report On Compliance And On Internal Control Over Financial Reporting Based On An Audit Of General-Purpose Financial Statements Performed In Accordance With Government Auditing Standards.....	5
---	---

### **SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

Section 1 - Summary Of Auditor's Results.....	8
Section 2 - Financial Statement Findings .....	9

#### **Reportable Conditions Relating To Internal Controls And/Or Compliance:**

None Noted For The Audit Period Ending June 30, 2000

#### **Other Matters Relating To Internal Controls And/Or Compliance:**

<u>Finding 00-REV-1</u> : The Revenue Cabinet Should Review Data Entry Logs To Ensure Completeness And Appropriateness Of Data Entry Procedures .....	9
--	---

Section 3 - Federal Award Findings And Questioned Costs.....	10
--	----

There Were No Federal Awards Audited For The Period Ending June 30, 2000

### **SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**

Summary Schedule Of Prior Audit Findings .....	12
--	----



## **INTRODUCTION**





**KENTUCKY REVENUE CABINET  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2000**

**Introduction**

The Auditor of Public Accounts (APA), acting as principal auditor in conjunction with various certified public accounting firms, annually performs a statewide single audit of the Commonwealth of Kentucky. This audit allows the Commonwealth to comply with federal audit requirements as set forth in the Single Audit Act of 1984, as amended by Public Law 104-156, and the regulations contained in the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

**Schedule of Findings and Questioned Costs**

The Schedule of Findings and Questioned Costs consists of three sections:

- Summary of Auditor's Results
- Financial Statement Findings
- Federal Award Findings and Questioned Costs

Each audit finding number and the audit finding's classification (as reportable, material, or other matters) is provided as part of the audit opinion summary. Major programs audited are listed on the Summary of Auditor's Results. The second part is the Financial Statement Findings. This part lists all the audit findings related to the financial statements. The third part, the Federal Award Findings and Questioned Costs, lists all findings related to federal awards. Generally, the state agency, CFDA number and program, federal agency, pass-through agency, and the compliance area the finding relates to are presented. In both parts two and three, reportable conditions and reportable instances of noncompliance are presented first, then material weaknesses and material instances of noncompliances, followed by other matters.

Audit findings reported in the Schedule of Findings and Questioned Costs for the fiscal year ended June 30, 1999 (as well as any previous findings which have not been resolved) are reported in the agency's Summary Schedule of Prior Audit Findings for the fiscal year ended June 30, 2000. If the APA determines the agency's Summary Schedule of Prior Audit Findings materially misrepresents the status of any prior audit finding, a new audit finding is issued and reported in the Schedule of Findings and Questioned Costs.

The Summary Schedule of Prior Audit Findings is organized based on whether the prior year finding was reportable, material, or other matters. The findings of each classification are categorized as (1) fully corrected, (2) not corrected or partially corrected, (3) corrective action taken differs significantly from corrective action previously reported, or (4) finding no longer valid or does not warrant further action. If a finding has been reclassified from material to reportable, for instance, the finding will appear in the material finding section of the summary schedule and the comment will indicate the reclassification. In the following year, the finding will appear in the reportable section of the summary schedule.

**KENTUCKY REVENUE CABINET  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2000  
(CONTINUED)**

**Audit Approach**

Our audit was conducted in accordance with the Single Audit Act Amendments of 1996, OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, *Government Auditing Standards* (also referred to as the Yellow Book), and generally accepted auditing standards. The scope of the statewide single audit for the year ended June 30, 2000, included:

- An audit of the general-purpose financial statements and required supplementary schedules in accordance with generally accepted government auditing standards;
- An audit of internal control applicable to the Kentucky Revenue Cabinet (KRC), to the extent necessary to consider and test the internal accounting and administrative control systems as required.

The APA conducted the audit of the internal control, focusing on the following objective:

- Considering the internal control in order to determine auditing procedures on the general-purpose financial statements of the Commonwealth.

**List Of Abbreviations/Acronyms Used In This Report**

APA	Auditor of Public Accounts
CFDA	Catalog of Federal Domestic Assistance
Commonwealth	Commonwealth of Kentucky
FY	Fiscal Year
KITES	Kentucky Integrated Tax Entity System
KRC	Kentucky Revenue Cabinet
KRS	Kentucky Revised Statutes
MFE	Modernized Front End
N/A	Not Applicable
REV	Revenue Cabinet
OMB	Office of Management and Budget
U.S.	United States

**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL**





EDWARD B. HATCHETT, JR.  
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky  
Honorable Paul E. Patton, Governor  
Dana Mayton, Secretary  
Kentucky Revenue Cabinet

Report On Compliance And On Internal Control Over  
Financial Reporting Based On An Audit Of General-Purpose  
Financial Statements Performed In Accordance With *Government Auditing Standards*

As part of the audit of the general-purpose financial statements of the Commonwealth of Kentucky as of and for the year ended June 30, 2000, we have audited receipts, refunds, account receivables, and contingent liabilities of the Kentucky Revenue Cabinet, an organizational unit of the Commonwealth of Kentucky as defined by KRS 12.010, and have issued our report thereon dated February 28, 2001. We conducted our audit in accordance with government auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Commonwealth's financial statements are free of material misstatement, we performed tests of Kentucky Revenue Cabinet's compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

To the People of Kentucky  
Honorable Paul E. Patton, Governor  
Dana Mayton, Secretary  
Kentucky Revenue Cabinet

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Kentucky Revenue Cabinet's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level, the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of Kentucky Revenue Cabinet.

This report is intended solely for the information and use of management and applicable federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ed Hatchett", with a long horizontal flourish extending to the right.

Edward B. Hatchett, Jr.  
Auditor of Public Accounts

February 23, 2001

## **SCHEDULE OF FINDINGS AND QUESTIONED COSTS**





**KENTUCKY REVENUE CABINET  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2000**

**SECTION 1 - SUMMARY OF AUDITOR'S RESULTS**

**Financial Statement Accounts**

Financial Statement Accounts: We issued an unqualified opinion on the Commonwealth of Kentucky's general-purpose financial statements, which include the Revenue Cabinet, as of and for the fiscal year ended June 30, 2000.

Schedule of Expenditures of Federal Awards: This section is not applicable to the Revenue Cabinet.

Internal Control Over Financial Reporting: Our consideration of the Revenue Cabinet's internal control over financial reporting disclosed no reportable conditions.

Compliance: In relation to the audit of the Revenue Cabinet's accounts that we audited, the results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

**Federal Awards And Schedule Of Expenditures Of Federal Awards**

This section is not applicable to the Revenue Cabinet.

**Identification Of Major Program Audited**

This section is not applicable to the Revenue Cabinet.

**Dollar Threshold Used To Distinguish Between Type A And Type B Programs**

This section is not applicable to the Revenue Cabinet.

**Auditee Qualified As Low-Risk Auditee?**

The Commonwealth did not qualify as a low-risk auditee.

**KENTUCKY REVENUE CABINET  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2000  
(CONTINUED)**

**SECTION 2 -FINANCIAL STATEMENT FINDINGS**

**Other Matters Relating To Internal Controls And/Or Compliance:**

**FINDING 00-REV-1: The Revenue Cabinet Should Review Data Entry Logs To Ensure Completeness And Appropriateness Of Data Entry Procedures**

---

During our FY 2000 audit of the Revenue Cabinet, we examined three months of data entry logs to ensure completeness and proper separation of duties between the entry operator and the verifying operator. In 21 instances we discovered that the logs were either incomplete or that the logs documented the failure to properly segregate duties. The following exceptions were noted:

- In one instance the Accounts Receivable log documented that the same operator performed the data and verification functions.
- In one instance the Sales Tax log lacked the documentation to specify the operators who entered and verified a batch of documents.
- In six instances an operator entered part of the batch and then verified the whole batch. Two occurrences were noted in the High Series log and four occurrences were discovered in the Refunds log.
- In one instance in the A-Series log the operator number of the person verifying batch data entered was missing.
- In twelve instances the entry operator number for the batch was missing from the log. The exceptions noted were as follows: four occurrences in the Withholding log, five occurrences in the Refunds (No Pays) log, and three occurrences in the A-Series log.

Not having complete data entry logs, or ensuring that data is entered and verified by different operators, increased the possibility of data entry errors.

A complete log recording the date of entry, the original entry operator number, and the verifying operator number should be kept. The log should be reviewed daily for missing information and batches that were entered and verified by the same operator. Further, data entered into the computer system should be verified unless there are sufficient compensating internal controls in operation to ensure the accuracy of the data. An operator other than the original entry operator should perform any verification needed.

**KENTUCKY REVENUE CABINET  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2000  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**Other Matters Relating To Internal Controls And/Or Compliance: (Continued)**

**FINDING 00-REV-1: The Revenue Cabinet Should Review Data Entry Logs To Ensure Completeness And Appropriateness Of Data Entry Procedures (Continued)**

---

**Recommendation**

We recommend that data entry section supervisors ensure that all batches are keyed and verified by separate operators. Further, supervisors should review data entry logs daily to ensure completeness and proper segregation of duties.

**Management's Response and Corrective Action Plan**

*The Kentucky Revenue Cabinet (KRC) agrees that all batches of tax returns or documents should be keyed and verified by separate data entry operators. It is Revenue Operations procedure to maintain complete and accurate data entry logs, showing the data entry user id of the persons entering and verifying a batch of returns or documents. Additionally, all batches of returns or documents should be entered and verified by different employees. These procedures apply regardless of tax type.*

*The data entry supervisors in Revenue Operations will work to ensure that all batches of tax returns or documents are entered and verified by separate operators. Next, supervisors will review the data entry logs on a daily basis to be sure they are complete and accurate. When errors are noted on the data entry logs, the supervisors will research the problem in a timely manner and take corrective action, as deemed necessary. These procedures should help to eliminate data entry errors and to improve overall data integrity.*

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

There were no federal award audit findings and questioned costs.

THIS PAGE LEFT BLANK INTENTIONALLY

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**



**KENTUCKY REVENUE CABINET  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2000**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Material Weaknesses</u></b>					
<b><i>(1) Audit findings that have been fully corrected:</i></b>					
1995	97-REV-24	The Revenue Cabinet Should Utilize the Automatic Log-off Feature For Information Management Systems And Customer Information Control System	N/A	0	The policy for password-protected screensavers was issued and employees were trained on the need for this precaution. Comment was dropped for FY 2000.
<b><i>(2) Audit findings not corrected or partially corrected:</i></b>					
There are no findings to report in this category.					
<b><i>(3) Corrective action taken is significantly different from corrective action previously reported:</i></b>					
There are no findings to report in this category.					
<b><i>(4) Audit finding is no longer valid:</i></b>					
1996	97-REV-25	The Revenue Cabinet Computer System Must Be Modified in Order to Process Year 2000 Data	N/A	0	The agency has completed compliance conversion and testing. The comment was downgraded to a verbal comment in 1999.

**KENTUCKY REVENUE CABINET  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2000  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Other Matters</u></b>					
<b><i>(1) Audit findings that have been fully corrected:</i></b>					
1996	KRC – 8	The Revenue Cabinet Should Have Procedures To Document Refund Requests As They Come Into The Revenue Cabinet	N/A	0	KRC has established a Standard Procedure for tracking all refund requests. The different divisions of the Cabinet forward all refund claims that are being held pending litigation to the division of Protest Resolution. An excel report is then produced and a quarterly report is prepared for the Secretary of the Cabinet to show amount of pending refunds.
1997	KRC – 6	The Revenue Cabinet Should Properly Safeguard Motor Fuel and Motor Usage Returns	N/A	0	Returns requested in testing were found. This will be cleared for the year ended June 30, 2000. However, it should be noted that other returns/files were not found in testing.
<b><i>(2) Audit findings not corrected or partially corrected:</i></b>					
1998	KRC-3	The Revenue Cabinet Should Ensure That Motor Fuel Reports Are Cross-Checked as Required	N/A	0	KRC has added three additional staff to the Motor Fuels Tax Section. Backlogs have been reduced to three or four years compared to five to seven in the previous audit finding
1997	KRC – 7	The Revenue Cabinet Should Properly Safeguard Corporation Tax Returns	N/A	0	There were problems again this year in obtaining corporate returns. KRC appears to be doing somewhat better however.



**KENTUCKY REVENUE CABINET  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2000  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Other Matters</u> (Continued)</b>					
<b><i>(2) Audit findings not corrected or partially corrected (Continued):</i></b>					
1998	KRC-1	The Revenue Cabinet Should Properly Safeguard Returns	N/A	0	Problems were again noted this year in obtaining various returns and tax documents.
<b><i>(3) Corrective action taken is significantly different from corrective action previously reported:</i></b>					
There are no findings to report in this category.					
<b><i>(4) Audit finding is no longer valid:</i></b>					
FY 95	KRC-11	The Revenue Cabinet Should Have Adequate Written Security Policies And Procedures Identifying Management And User Responsibilities For System Security	N/A	0	Sufficient action was taken on the prior year's recommendation. The comment was downgraded to a verbal comment for FY 2000.
FY 96	KRC-12	The Revenue Cabinet Should Strengthen Physical Security At The Perimeter Park Building	N/A	0	Sufficient progress was made during the year to downgrade the comment. The comment was issued as a verbal comment for FY 2000.